


GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Chief Financial Officer



Office of Integrity and Oversight

MEMORANDUM

TO: Stephen M. Cordi, Deputy Chief Financial Officer
Office of Tax and Revenue

FROM: William J. DiVello, Executive Director
Office of Integrity and Oversight 

DATE: November 14, 2011

SUBJECT: Final Fraud Follow-up Report: Individual Income Tax Refunds Issued
Fraudulently (**Report No. 0011-0088**)

This memorandum summarizes the results of the Office of Integrity and Oversight's (OIO) fraud follow-up report. The purpose of this memorandum was to assess the actions taken by the Office of Tax and Revenue (OTR) to address the breach of internal controls within the Compliance Administration Adjustment Unit which resulted in an employee's ability to fraudulently receive over \$400,000 in individual income tax refunds.

OIO provided nine (9) recommendations to correct deficiencies associated with this fraud. OTR generally concurred with the recommendations and provided corrective action plans; however, we request OTR to reconsider its planned actions for recommendation 6 as it relates to withholding matching with employer data, and to provide target completion dates for recommendations 4, 5, 8, and 9. The OTR response in its entirety is attached as Exhibit B.

BACKGROUND

On January 7, 2011, the DCFO of the Office of Tax and Revenue alerted the Office of Integrity and Oversight (OIO) to a potential fraudulent refund scheme. The potential fraud was uncovered by the OTR Revenue Accounting Administration (RAA) during a comparative analysis of the Refund Tracking Report for the period October 2010 to October 2009. The RAA reviews the refund tracking report on a monthly basis to compare refund volume from year to year. In the review of the October 2010 refunds compared to October 2009, there was a \$2 million difference in the dollar value of refunds issued in individual income.

To determine the cause of the variance, the RAA staff ran a detailed refund report and noticed a 2001 tax year return with a refund in October 2010. This refund did not seem proper, as the

2001 return year is outside of the statute of limitations; therefore, RAA reviewed the taxpayer's account noting five refunds were sent out on the taxpayers 2001 tax year filing. The RAA assistant manager alerted OTR management, who in turn, contacted the Office of Integrity and Oversight for further action.

METHODOLOGY

To determine the magnitude of the fraudulent activity, the OIO performed a series of system queries of the employee's ITS usage. Initially, OIO scanned all direct deposit bank activity and noted the same bank and bank account numbers were used for four (4) different taxpayers and approved by the employee under investigation (the subject). OIO obtained the subject's PeopleSoft Payroll data and noted the two bank accounts used to deposit the fraudulent refunds were the employee's payroll check direct deposit accounts. The bank accounts were either included in the initial filing or through the subject's modification of the direct deposit information in the ITS client profile.

Additionally, OIO worked with the Office of the Chief Information Officer (OCIO) Tax Systems Group (TSG) to run more queries of the subject's adjustment activity, refund activity, direct deposit modifications and identify patterns. OIO also reviewed other Adjustment Unit employees and matched Payroll direct deposit information against refunds issued through ITS.

FINDINGS AND RECOMMENDATIONS

Finding 1: Fraudulent Refunds Totaling \$417,040 Were Undetected at the OTR

An employee within the OTR Compliance Administration Collections Adjustment Unit used their ITS adjustment rights to create fraudulent refunds. The employee used nine (9) different taxpayer accounts to generate 65 fraudulent refunds totaling \$417,040 from Calendar Year 2007 to 2011. To create the refunds, the employee posted fraudulent adjustments to the taxpayer account period tax return filing in the Integrated Tax System (ITS) using amended adjustments, tax credits and withholding transaction types. Additionally, the subject approved the refunds these transactions created. To justify the adjustments in many instances, the subject placed notes in ITS to explain the adjustment activity.

The fraudulent activity can be attributed to internal control weaknesses in the adjustment and refund process. After the discovery of fraud in 2007 in the OTR Real Property Tax Administration, OTR reduced the number of employees with adjustment rights in ITS, redefined user classes within ITS based on employee job descriptions, and created an adjustment unit within the Compliance and Customer Service Administrations as well as implemented a tiered refund review for refunds greater than \$10,000.

The Integrated Tax System (ITS) is designed to allow the user to resolve tax issues in real-time. To perform duties within ITS, employees are given user rights. Employees within the adjustment unit may not only adjust accounts but they may also approve refunds. For refunds

greater than \$10,000, a manual business process was put in place in FY 2008 to require a tiered review of the refund by senior management. If an employee approves a refund greater than \$10,000, but is not on file as an authorized approver for this higher threshold, the Revenue Accounting Administration sets the refund back to pending to obtain adequate supporting documentation and signatures by senior management. This manual review process does not exist for automated refunds less than \$10,000.

The Compliance Collections Adjustment Unit business process required adjustments received by the adjustment unit to go through a tiered review and entry in a tracking log before entry in the Integrated Tax System; however, there was no match of actual adjustments performed against the tracking log to determine if unauthorized transactions were processed. This lack of management oversight coupled with the fact that the fraudulent refunds were less than \$10,000 allowed the fraud to go undetected.

The Government Accountability Office (GAO) in its publication, *Standards of Internal Control in the Federal Government* states the following:

"Management should provide qualified and continuous supervision to ensure that internal control objectives are achieved."

*"Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating responsibilities for authorizing transactions, processing and recording them, reviewing the transaction, and handling any related assets. No one individual should control all key aspects of a transaction or event."*¹

As a result of this lack of managerial oversight and segregation of duties, fraudulent adjustments and refunds were generated and approved by the same employee.

Recommendations:

OIO recommends the Deputy Chief Financial Officer, OTR take action to:

1. Modify user classes within the Integrated Tax System to remove the ability for an employee to both adjust and approve refunds within an account.

Agency Response:

OTR concurs with this recommendation. OTR is in the process of making the necessary changes in access and procedures to accomplish this segregation. The entire process is targeted for completion by May 31, 2012.

OIO Comment:

¹ U.S. Government Accountability Office (GAO), formerly U.S. General Accounting Office; *Internal Control Standards in the Federal Government*, Report Number GAO/AIMD-00-21.3.1; November 1999, page 14

We consider OTR's planned action when completed to be responsive to this recommendation.

2. Review tracking logs and compare the logs to the adjustment report to determine if accounts were adjusted that were not assigned to an employee.

Agency Response:

OTR concurs and has implemented this recommendation. OTR has put procedures in place for the review of all changes to accounts by employees. These reports track all changes even if they do not result in an immediate tax refund to a taxpayer.

OIO Comment:

We consider OTR's action to be responsive to this recommendation.

Finding 2: The Employee Altered Direct Deposit Information To Divert Funds To Their Personal Bank Account

District taxpayers may have refunds sent by mail or to their bank account by providing their bank routing number and account number on the return. This information is keyed at the time the return is filed and stored in the taxpayer's client profile. We found that the subject had the ability to change the direct deposit information in ITS without management or taxpayer approval.

Due to the way that the refund register report is designed, the bank account number is not included in the register report nor is there a systemic check to determine if the bank account was used by a different taxpayer. The subject used this knowledge to change the direct deposit information for several taxpayers to divert funds to the subject's personal bank accounts which went undetected.

The Government Accountability Office (GAO) in its publication, *Standards of Internal Control in the Federal Government* states the following:

"Transactions and other significant events should be authorized and executed only by persons acting within the scope of their authority. This is the principal means of assuring that only valid transactions to exchange, transfer, use, or commit resources and other events are initiated or entered into Authorizations should be clearly communicated to managers and employees."

"Access to resources and records should be limited to authorized individuals, and accountability for their custody and use should be assigned and maintained. Periodic comparison of resources with the recorded accountability should be made to help reduce the risk of errors, fraud, misuse, or unauthorized alteration."

Direct deposit information is sensitive data that should be safeguarded and should only be changed if there is documentation from the taxpayer or a data transcription error. In those instances the number of employees with this modification capability should be limited.

Recommendation:

We recommend the Deputy Chief Financial Officer, OTR:

3. Restrict the ability to modify direct deposit information to select employees most likely within the Customer Service Administration.

Agency Response:

OTR concurs with this recommendation. OTR is analyzing the cost of implementing this recommendation in the current system. In the interim, we are monitoring the system for these changes and will review the change reports to determine if employees are not following the current prohibition on making these changes. The entire process is targeted for completion by May 2012.

OIO Comment:

We consider OTR's planned action when completed to be responsive to this recommendation.

4. Perform a periodic review to compare direct deposit account information to employee bank account information to determine if there are any matches and whether the matches are appropriate.

Agency Response:

OTR concurs with this recommendation. OTR will request the account information from the Office of the Treasurer and the Payroll Office.

OIO Comment:

We consider OTR's planned action to be responsive to this recommendation. However, a date for the implementation was not provided. OIO requests a planned implementation date for the receipt of information from the respective agencies.

5. Perform periodic review or testing of refunds going to the same bank account or multiple refunds to the same taxpayer for the same tax period.

Agency Response:

OTR concurs with this recommendation. OTR's Revenue Accounting Administration has developed a program to test and review refunds for both of these issues. We are adding staff to RAA to help in refund verification and testing.

OIO Comment:

We consider OTR's planned action to be responsive to this recommendation. However, a date for the hiring of additional staff was not provided. OIO requests a planned implementation date.

Finding 3: Withholding Amounts Filed by Taxpayers were Altered to Create Fraudulent Refunds

The subject was able to create the fraudulent refunds through adjustments to tax returns filed via paper or through electronic filing. Frequently, the subject increased the taxpayer's withholding credit, thus generating a refund. For example, in one taxpayer's account, the withholding was originally filed with \$561. After all adjustments were made to the taxpayers account, the withholding line totals \$61,556.

Currently, OTR is matching withholding on a limited basis; however, this match is only performed against the original return filing and the employer withholding file at the time the return is filed. If there are additions made to the withholding credit after the return has posted to the client profile, there are no subsequent matches with the employer withholding records to detect this change.

Additionally, the withholding adjustment transaction type was not included in the adjustment report created by OTR in an attempt to review adjustments on a sample basis; therefore, these changes were undetected.

Recommendations:

We recommend the Deputy Chief Financial Officer, OTR direct the Tax Systems Group to:

6. Continue to look for a data capture solution to capture all W-2 data and perform matching with employer data. As part of this, OTR should determine if there is a systemic way to 'lock' an account from withholding changes once the account has been reconciled to the employer account.

Agency Response:

OTR concurs with this recommendation. Currently OTR is receiving W-2 data through electronic filing which constitutes approximately 60% of the individual filing population. We are still challenged with entering the employer data into our system because it is received in various formats including paper. We agree that locking the withholding amount into the system is a good idea but it is probably not a viable option before the new system implementation due to resource issues. New system implementation will determine a full completion date.

OIO Comment:

We strongly urge OTR reconsider the actions taken to resolve this finding. It is imperative that employer/employee withholding is captured and matched in a timely manner to reduce fraudulent individual income refunds and strengthen compliance efforts. This resolution is needed prior to the implementation of a new system.

7. Ensure the withholding adjustment transaction type is included in the adjustment transaction report for management review.

Agency Response:

OTR concurs with this recommendation. This recommendation has been implemented.

OIO Comment:

We consider OTR's action to be responsive to this recommendation.

Finding 4: Fraudulent Tax Returns were Filed

D.C. tax law provides adjustments to the Federal adjusted gross income for several programs that are administered by other D.C. Government agencies. These programs include:

- First time home buyers credit² for certain D.C. Government employees [Administered by the Department of Housing and Community Development];
- D.C. College Savings Plan payments up to \$4,000 where the taxpayer is the owner of the account and \$8,000 when filing a joint return and each spouse is a sole owner of an account,
- contributions in excess of the \$4,000/\$8,000 limitations are carried forward to the next year [Administered by Office of Finance and Treasury(OFT) through a contractor];
- Expenditures by D.C. Public Schools (DCPS) teachers for supplies (\$500) and professional development (\$1,500) for teachers who have been a classroom teacher for the entire tax year or the entire prior tax year;
- Long term care credits; and
- Exclusion of \$10,000 for individuals who are determined to be totally and permanently disabled, by the Social Security Administration, and receiving Supplemental Social Security Income, Disability Income, railroad retirement disability benefits, or Federal and/or D.C.

² This first time home buyer's credit appears to be in addition to the \$5,000 credit provided in the Internal Revenue Code.

Government disability benefits. Limited to households where the income is less than \$100,000.

These credits are claimed on the Schedule I of the D-40 tax return. In review of the returns filed in this refund scheme, some or all of the credits were claimed to reduce taxpayer liability. It does not appear that these credits are subject to systemic checks to ensure that amounts claimed on returns are legitimate and valid. Revenue protection is paramount in tax administration to protect the assets of the District.

Recommendations:

We recommend the Deputy Chief Financial Officer, OTR take action to:

8. Obtain listings from DCPS, OFT, and other agencies to ensure that claimants are actually entitled to the various credits.

Agency Response:

OTR concurs with this recommendation. We will request lists of participants from these and other agencies.

OIO Comment:

We consider OTR's planned action to be responsive to this recommendation. However, a date for the implementation was not provided. OIO requests a planned implementation date.

9. Forward any questionable returns to the Compliance Administration Audit Division and/or Criminal Investigations Division for further action.

Agency Response:

OTR concurs with this recommendation.

OIO Comment:

We consider OTR's planned action to be responsive to this recommendation. However, a date for the implementation was not provided. OIO requests a planned implementation date.

PRIOR OIO REVIEWS

The Office of Integrity and Oversight issued several memorandums and reports to the Office of Tax and Revenue specifically regarding internal control weaknesses in the Integrated Tax System that warranted further action. These reviews included:

Management Alert: Integrated Tax Systems Systemic Weaknesses Hamper Internal Controls

In this management alert dated January 31, 2008, the Office of Integrity and Oversight cautioned the OTR that there were inadequate controls over the ability to make on-line adjustments without management approval. Additionally, refunds that are produced as a result of these on-line adjustments are not reviewed by management. We recommended the OTR review the entire adjustment process to determine what changes could be made to improve the internal controls.

Memorandum: Review of Employee's Activity in ITS based on Dummy Account Alert (IA:OTR:2904:M02)

In this memorandum dated February 27, 2009, the OIO found that an employee was able to make inappropriate adjustments in the system without managerial oversight. We found that the lack of managerial oversight allowed excessive privileges in ITS. As a result, we strongly recommended that the RPA Acting Director develop stringent procedures for adjustments to taxpayer accounts ensuring that there are controls in place throughout the process. The procedures should include adequate and appropriate managerial oversight.

Memorandum: Results of our Review of OTR Refunds (IAOTR:2807:M04)

In this memorandum dated March 13, 2009, the OIO found that there was a lack of review of refunds less than \$10,000 which left the agency vulnerable to error and fraud. We recommended OTR incorporate a review of refunds less than \$10,000 on a sample basis as part of its effort to safeguard the District's assets.

Memorandum: Review of Audit Adjustments User Rights in ITS (IA:OTR:2904:C08)

In this memorandum dated March 23, 2009, the OIO found that audit assistants were not technically proficient to enter audit adjustments. We recommended that the Compliance Administration create a group of technically trained auditors enter the adjustments after the adjustments have been reviewed in Review and Conference. This would allow audit staff to focus on their audits and decrease the number of staff posting to the system. We recommended the audit division develop written policies and procedures documenting the adjustment process to ensure consistency and uniformity throughout the Audit Division and Compliance Administration. We also recommended the review of management reports to identify the status of cases in the case management system to allow for follow-up actions and to look for unusual adjusted items.

Fraud Follow-up Report
November 14, 2011
Page 10

In the draft memorandum dated September 20, 2011; OIO requested OTR provide a status of prior year OIO reviews. As of the date of this memorandum, OTR requested and was granted an extension for their response as to the status of prior year OIO reviews. The agency response is due to our office by December 5, 2011. If you have any questions regarding this report, contact me at 442-6433 or a member of your staff may contact Mohamad Yusuff, Director, Internal Audit at 442-8240.

cc: Natwar M. Gandhi, Chief Financial Officer
Angell Jacobs, Director of Operations
Kathy Crader, Chief Risk Officer
Glen Groff, Director of Operations, OTR

Exhibit A: Summary of Potential Benefits Resulting from Audit

Recommendation	Description of Benefit	Amount and Type of Benefit	Agency Reported Estimated Completion Date	Status³
1	Modify user classes within ITS to remove ability to both adjust and approve refunds.	Internal Control	May 31, 2012	Open
2	Review tracking logs and compare the logs to the adjustment report	Internal Control	October 28, 2011	Closed
3	Restrict the ability to modify direct deposit information to select employees.	Internal Control	May 2012	Open
4	Perform a periodic review to compare direct deposit account information to employee bank account information.	Internal Control	TBD	Open
5	Perform a periodic review or testing of refunds going to the same bank account or multiple refunds to the same taxpayer for the same period	Internal Control	TBD	Open
6	Continue to look for a data capture solution to capture all W-2 data and perform matching with employer data	Internal Control	TBD	Unresolved
7	Ensure the withholding adjustment transaction type is included in the adjustment transaction report for management review	Internal Control	October 28, 2011	Closed
8	Obtain listings from DCPS, OFT, and other agencies to ensure that claimants are actually entitled to the various credits	Internal Control Compliance	TBD	Open
9	Forward any questionable returns to the Compliance Administration Audit Division and/or Criminal Investigation Division for further action	Compliance	TBD	Open

³ This column provides the status of the recommendation as of the report date. For final reports, “**Open**” means management and the OIO are in agreement on the action to be taken, but the action is not complete. “**Closed**” means that management advised the OIO that the action needed to correct the condition is complete. If a completion date was not provided, the date of management’s response was used. “**Unresolved**” means that management has neither agreed to take the recommended action nor proposed satisfactory alternative actions to correct the condition.

Exhibit B: OTR Response

GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE CHIEF FINANCIAL OFFICER
OFFICE OF TAX AND REVENUE



Stephen M. Cordi
Deputy Chief Financial Officer

MEMORANDUM

TO: William J. DiVello, Executive Director
Office of Integrity and Oversight

FROM: Stephen M. Cordi
Deputy Chief Financial Officer

DATE: October 28, 2011

SUBJECT: Fraud Follow-up Report: Individual Income Tax Refunds Issued Fraudulently
(IS: 0011-0088)

The Office of Tax and Revenue agrees with the recommendations of the Office of Integrity and Oversight in this matter. This response will outline the steps that OTR has or will take in response to your recommendations.

Recommendations:

1. Modify user classes within the Integrated Tax System to remove the ability for an employee to both adjust and approve refunds within an account.

Response

OTR concurs with this recommendation. We are in the process of making the necessary changes in access and procedures to accomplish this segregation. The first administration to undergo the change will be the compliance administration. The work flow study has already been undertaken and it is anticipated that the necessary access and procedure changes will be accomplished by the end of the year. Implementation in the other divisions will follow rapidly once we have identified any bugs in the process during the initial change. All employees will be trained in the new procedures as they are implemented. The entire process is targeted for completion by May 31, 2012.

2. Review tracking logs and compare the logs to the adjustment report to determine if accounts were adjusted that were not assigned to an employee.

Exhibit B: OTR Response

Response

OTR concurs with this recommendation and has put procedures in place for the review of all changes to accounts by employees. These reports track all changes even if they do not result in an immediate tax refund to a taxpayer. We found flaws in the initial reports and have corrected those omissions. Implemented

3. Restrict the ability to modify direct deposit information to select employees most likely within the Customer Service Administration.

Response

OTR concurs with this recommendation. We are analyzing the cost of implementing this recommendation in the current system. In the interim the changes we have instituted to system access by employees limits our exposure to this type of change in the short run. We are able to monitor the system for these changes and will review the changed reports to determine if employees are not following the current prohibition on making these changes. OTR hopes that this change will be one that can be made relatively easily after all of the current filing season modifications have been completed. Partially implemented; full implementation by May 2012.

4. Perform a periodic review to compare direct deposit account information to employee bank information to determine if there are any matches and whether the matches are appropriate.

Response

OTR agrees that this is an excellent method of detecting some employee fraud. OTR will request the account information from the Office of the Treasurer and the Payroll Office in order to perform the tests. It is suggested that the match be a semi-annual match initially.

5. Perform periodic review or testing of refunds going to the same bank account or multiple refunds to the same taxpayer for the same tax period.

Response

OTR concurs with this recommendation. OTR's Revenue Accounting Administration has developed a program to test and review refunds for both of these issues. This program is currently producing more results than we can investigate with the current staffing levels. We are adding staff to RAA to help in refund verification and testing. Implemented

6. Continue to look for a data capture solution to capture all W-2 data and perform matching with employer data. As a part of this, OTR should determine if there is a systemic way to 'lock' an account from withholding changes once the account has been reconciled to the employer account.

Exhibit B: OTR Response

Response

OTR concurs with this recommendation. Currently OTR is receiving W-2 data through electronic filing which constitutes approximately 60% of the individual filing population. We are still challenged with entering the employer data into our system because it is received in various formats including paper. We are conducting limited tests with the data but are unable to have a fully comprehensive program because of systemic and staff restrictions. We agree that locking the withholding amount into the system is a good idea but once again it is probably not a viable option before the new system implementation due to resource issues. New system implementation will determine a full completion date.

7. Ensure the withholding adjustment transaction type is included in the adjustment transaction report for management review.

Response

OTR concurs with this recommendation. This recommendation has already been implemented into our reporting system for management review. Implemented

8. Obtain listings from DCPS, OFI, and other agencies to ensure that claimants are actually entitled to the various credits.

Response

OTR concurs with this recommendation. We will request lists of participants from these and other agencies. The lists will be compared to those claiming the credits and any mismatches will be resolved.

9. Forward any questionable returns to the Compliance Administration, Audit Division and/or Criminal Investigation Division for further action.

Response

OTR concurs with this recommendation and will implement it.

If you have any additional questions, please feel free to contact Glen Groff, Director of Operations, at 442-6499.